Judge Institute of Management Studies
Cambridge University
May 4, 1995

Policy Formation and Values (Easter Term 1995)
Special Session Corporate Governance Symposium

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The Cold War is over; Communism and centrally directed socialist economics lost. I am going to talk today about one of the winners -- the publicly owned multi-national corporation, a phenomena of the anglophone world -- and how it relates to a free society. Corporate Governance has two distinct facets: a political one concerned with the vast power agglomerated in large corporations and how the rights of individual citizens are safeguarded and an economic one focused on the commercial viability of the enterprise in the face of world wide competition.

I will try to provide insight into the workings of corporate governance by considering one of the most serious of current problems -- the compensation of top executives. In a rather free form progression, we will consider a dozen scenarios illuminating an aspect of the implications of the current theory and practice of top executive pay. Each episode will contain three parts -- the narrative itself, a consideration of the corporate governance considerations -- some political, others economic, and some with elements of both, and finally a section on “language”. Ultimately, I will speculate briefly on why so many sincere and well informed people knowingly misuse words in the context of corporate governance and will suggest some general conclusions.

A final word about what Sir Winston Churchill correctly described as the “common language which separates us.” I will describe the situation in the United States and will use words with their American connotation. I am not unfamiliar with the circumstances in the United Kingdom, but want to be sure not to confuse with my prepared remarks.

Executive Compensation

Narrative Corporate Governance

Implications Language

1. “In a free enterprise, private property system, a corporate executive is an employee of the owners of the business” Milton Friedman There is unmistakable conflict of interest between management and owners in setting a level of pay for top managers. In this field, owners’ knowing ratification is necessary to make legitimate the pay.

Is “employee” the correct description for the individual who, in actual fact, controls the enterprise?
2. Compensation levels are set by the “market place.” This is the ultimate reality in a capitalistic economy. Is there such a thing as a free “market place” for management pay? How many instances of competition exist? It is troubling that defenders of pay packages should rely on and advertise a concept that is plainly inappropriate.

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3. ”Executive Directors’ pay should be subject to the recommendations of a remuneration committee made by wholly or mainly of non-executive directors.” Cadbury Commission 3.3 This effort to avoid having management appear to set its own pay is an example of using words rather than reality. Directors are part of a self perpetuating process in which they are selected by those whose pay they are supposed “independently” to set. Is not the notion of “independence” utterly misleading in the context where directors are appointed -- not elected in any meaningful sense -- and never without the acquiescence of management. And yet, particular individuals are entirely capable of independence. 4. “[A]n increasing number of remuneration committees will call for direct independent external consulting advice so that they can assess a wider range of options than those put by up the CEO.” Corporate Governance, An International Review, Vol 3, No 2 (April 1995, p. 65) Consulting firms live in the real world in which management is in control of the preponderance of their work opportunities. Can independent consultants make a living. See Graef Crystal? Do remuneration committees set their own compensation. “Log rolling.” Again, the language of independence is in contrast with the reality of co-optation. Power is self contained, but note: ”Many chief executives have lost control of their Compensation committees.” Business Week, March 27, 1995 at p. 36.

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5. “[T]he 200 largest corporations set aside nearly 10% of their stock for top executives.... in almost all cases, moreover, it’s the superstar CEO who takes the lion’s share of these stock rewards.” Business Week, April 24, 1995 p. 93. The structures of governance appear to have been inadequate to the challenge of resisting top management’s (CEO) ability to award itself ownership of the venture that has vastly exceeded in value traditional levels of appropriate compensation. Management can hardly be called employees or agents; they have become partners, at least “on the Upside.” They do not actually have money at risk on the down side. See CEO Michael Jordan’s 1,000,000 “out of the money” stock options at Westinghouse.

6. The levels of management pay in the United States are the highest in history from several perspectives -- comparison with the past, with other countries, and the gap between entry level and CEO. Salaried employees bargain for their compensation. Levels have not risen as fast as for the CEOs. Has top management become a new species-- something between owner and employee? Eisner, Goizetta, O’Reilly.

If management is an economic partner, what additional responsibilities does it assume as part of this bargain? Is it appropriate for management unilaterally to seize this status?

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7. Pay has not risen faster than the level of stock prices. Is there any corporate body, other than owners, with the power to authorize a direct correlation between pay and stock price? Without such authorization, is such a compensation practice “legitimate” One pays agents; one contracts with partners -- the modern relationship with management is neither of these. If management has unlimited power with respect to its own compensation, are there any limits on its power elsewhere?

8. Critics of the high level of pay have been unable to correlate good/bad performance with management pay levels. Is pay primarily a social policy concern -- the permissible gap between rich and poor in a democratic society.

Does man live by bread alone? - agency theory;

-stewardship theory

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9. Does the existence of a commercial sector with the prospect of pay levels vastly higher than other alternatives Injure society? "..[C]ompensation has an important effect in determining which sectors of society claim the largest shares from the finite pool of intellectual talent available to meet the nation's growing needs" Bok, The Cost of Talent,(Macmillan 1993 p. 91) Is top executive pay too important a subject to be decided by business (in the sense that war is too important to be exclusively the province of generals)? {Over 80% of a Yale class of the late '80s applied for a job with a single investment banking firm - Morgan Stanley. 10. The independent accounting agency responsible for setting standards (FASB) recommended that the present cost of options be charged against earnings. The Business Roundtable representing big business successfully defeated this proposal. When business is able to control the rules of the society within which it functions, the questions need be raised as to whether there exists a satisfactory level of accountability. See William Greider, Citizen GE. Businesses control of lobbying and legal talent gives it the power to define the rules under which it operates. Is government sufficiently independent of business. See data relating to contributions to political campaigns.

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11. "A number of high profile public companies such as British Gas, have decided to scrap their share option schemes, which require shareholder approval, and introduce long term incentive schemes which do not." Financial Times, April 10, 1995, p. 7. The practice of changing process so as to eliminate owners' participation is becoming wide spread. Note in particular the Delaware courts' decisions in the Time v. Warner cases. That the most prominent public companies blithely enrich their managements and eliminate owners' involvement without a "by your leave" is the most informative description of the status of shareholder rights in today's world. Shareholders have the rights that management finds it unthreatening to permit them.

12. Do not well meaning requirements that all of the components of pay be clearly disclosed simply cause frustration because of the ultimate inability of owners or others effectively to be involved in the process? Is there a difference between economic governance where what works (competitiveness) is acceptable and political governance (legitimacy) where real accountability is necessary. Advertising that groups have "power" when in fact they do not creates a dangerous situation -- under the name of openness and process, power and property are, in fact, being reallocated.

Arguably, our brief tour of the field of executive compensation has generated the following "facts":

· Directors are not elected

· Neither directors nor consultants are independent

· There is no legitimating “market place” to validity the levels of executive pay

· CEO hegemony is unmistakable

· Shareholder “power” is an oxymoron

· Corporate power threatens the legitimacy of government institutions in a free society.

Why is it such common practice for academics, politicians and all manner of practitioner to continue to use “governance” vocabulary in a misleading way, which denies the conclusions we have set forth just above. There are several explanations. Two suggest themselves. First it is simply a question of power or as it is cynically called -- the “golden rule” -- them that has the gold, rules. Alternatively, the modality of business success requires its own language. The present power equilibrium between business and society is optimal, but is more palatably clothed in the vocabulary of democratic practice. In a free n is the need to appear to be “open,” to have legitimate process, votes, elections and independence.

The questions about language are eminently worthwhile, because capitalism is based on certain premises that have created tension over the centuries. Among many is that keystone of liberal politics since Rousseau and Locke that man is created equal. I am put in mind of those two post World War II drop-outs from Harvard College -- Edwin Land, the proprietor of Polaroid and Bill Gates of Microsoft. Their genius has created hundreds of thousands of jobs and has enhanced the living conditions of virtually everyone on earth and they became among the richest inhabitants. Their inequality with the rest of us is undeniable and critically important. The three quarter century experiment in governmental control in Eastern Europe has proven to the satisfaction of those now alive that denial of the special ability of the few results in frustration for all. The challenge is to enable and empower the energy of genius. This problem -- written in large institutional terms -- is the concern of Corporate Governance. Only, if we are able to deal with difficult questions, like those relating to executive compensation, will it be clear that there is yet a winner of the Cold War.